Testimony of the Honorable Michael M. Reyna
Chairman and Chief Executive Officer
Farm Credit Administration
before the
Subcommittee on Agriculture, Rural Development,
Food and Drug Administration, and Related Agencies
Committee on Appropriations
U.S. House of Representatives
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Mr. Chairman, Members of the Subcommittee, I am Michael Reyna, Chairman and Chief Executive Officer of the Farm Credit Administration (FCA or Agency). This is my first report to you as the new Chairman of the FCA Board.

We were surprised and saddened by the loss of our friend and colleague, Marsha Pyle Martin, who suddenly passed away on January 9. The Farm Credit System (FCS or System), as well as America's farmers and ranchers lost a very special person who worked tirelessly for them and for all of agriculture. Marsha was a lifelong advocate for farmers, ranchers, and rural America and she will be greatly missed. My fellow board member Ann Jorgensen and I are committed to continuing FCA' s work, ensuring a safe and sound FCS that provides dependable credit for agriculture and rural America.

I will highlight FCA's accomplishments during the past year, report briefly on the condition of the FCS, and present our fiscal year (FY) 2001 budget request. We formally submitted our proposed budget and Annual Performance Plan to the Committee on February 7, 2000.

MISSION OF THE FARM CREDIT ADMINISTRATION

Our mission is to promote a safe and sound, competitive Farm Credit System so that agriculture and rural America will continue to have a permanent source of credit in both good times and bad. We are not involved in the daily management of System institutions, but rather ensure that the System complies with the law and regulations, and operates using safe and sound banking practices. We believe that the FCS will continue to play an important role in agriculture in the 21st century. We strive to provide a regulatory environment that enables the System to meet rural America's changing demands for credit and other financial services. In doing so, our primary focus is to ensure the long-term safety and soundness of the FCS and develop rules and policies that respect market forces.

FISCAL YEAR 1999 ACCOMPLISHMENTS

I am proud of our many accomplishments this past year. In fiscal year 1999, we continued our commitment to improving efficiency, minimizing the cost burden on FCS borrowers, adding value in everything we do, and helping our customers meet the challenges and opportunities of the approaching millennium. During the year, we improved our strategic planning and implementation process, refining the Annual Performance Plan, and further enhancing our risk identification capabilities. We also installed a new accounting system that uses the client/server architecture to increase efficiency. Moreover, we continued to reduce regulatory burden during FY 1999 without compromising our ability to oversee the safety and soundness of System institutions.

Examination Programs

One of our highest priorities is the development and implementation of efficient and innovative examination programs that meet the high standards and expectations of our customers. We conduct examinations according to risk-based examination principles, which means we set the scope and frequency of each examination based on the level of risk in the institution. We continuously identify, evaluate, and proactively address these risks. We also use an examination cycle of up to 18 months on certain institutions, where appropriate, and as permitted by the Farm Credit System Reform Act of 1996.

We continue to enhance our risk identification capabilities. Our Early Warning System identifies existing and prospective risk in FCS institutions. Each institution is reviewed quarterly to identify changes in its risk characteristics, and the Financial Institution Rating System (FIRS) rating is adjusted as needed. In addition, we use our forecasting model semiannually to identify and evaluate prospective risk in FCS institutions over the next 12 to 24 months under “most likely” and “worst case” scenarios. This includes monitoring trends in prices for various commodities. This proactive approach is intended to evaluate an institution's financial condition and performance under various scenarios to identify institutions with emerging risks and the potential for deterioration. This allows us to implement our differential supervision program to address and correct potential problems. We continue to enhance our modeling capabilities so that we can identify in a timely manner economic developments that may affect the financial condition of FCS institutions.

During fiscal year 1999, other Federal agencies used our expertise. The Small Business Administration (SBA) asked FCA to provide examinations of Small Business Lending Companies that are licensed to make SBA guaranteed loans. Also, officials at the Office of Thrift Supervision (OTS), recognized the increased lending activity in agriculture by the thrifts it regulates and examines. OTS asked us for assistance in training their staff. These arrangements help us maintain the high quality skills of our examiners and help to defray some of the costs of operations.

Effective Communications

We are committed to maintaining effective communications with our constituencies. The FCA Board meets annually for information exchanges with the board chairmen and chief executive officers of nearly all System institutions. These meetings provide us the opportunity for effective two-way communication on important topics affecting the System and the Agency's internal operations. FCA Board members, executives, and staff also visit System institutions and other agricultural organizations throughout the year to keep in touch with important issues at the grass roots level.

We recently sponsored a Regulators' Agricultural Risk Conference. The conference provided a forum for agricultural economic experts and financial institution regulators to discuss the current state and future prospects for U.S. agricultural markets and the potential risks for financial institutions. The conference also provided a forum to hear firsthand from financial regulators about how the problems in the agricultural sector are affecting the institutions they regulate.

Strategic Planning and Performance Plans

Improving the strategic planning and implementation process to better meet our congressional mandate and requirements of the Government Performance and Results Act of 1993 (Results Act) was a key objective during FY 1999. The Board's vision is for FCA to be the premier regulator for financial institutions, ensuring dependable credit for agriculture and rural America. In keeping with this vision, and to help guide operations, the Board adopted two strategic goals for fiscal years 1998-2003:

1. Supervise risk in the Farm Credit System for the benefit of stakeholders.

2. Maximize opportunities for the Farm Credit System to provide competitive and dependable services for agriculture and rural America.

The Strategic Plan contains eight objectives designed to ensure the Agency meets these goals.

During FY 1999, we focused on implementing the strategic plan and developing methods for measuring the Agency's performance. We refined the Annual Performance Plan covering FY 2000 and 2001 in accordance with the Results Act. The Performance Plan lists our performance measures and goals, many of which link to our strategic goals, objectives, and initiatives. We use these performance measures and goals to assess our ultimate effectiveness in ensuring the safe and sound operation of the FCS.

We have developed an integrated performance measurement system that measures and evaluates the Agency's results, as well as individual staff member's contributions. We linked our performance measurements with the performance standards for all professional staff. These measurements are evaluated at the staff members' mid-year and annual performance reviews.

Year 2000 Compliance

We continued to devote much attention to the Year 2000 (Y2K) technology problem during FY 1999. Internally, we successfully implemented a detailed action plan to address Y2K issues. Externally, through our examination activities we closely monitored FCS institutions' efforts to become Year 2000 ready. We also surveyed FCS institutions quarterly to measure their progress. As of September 30, 1999, all FCS institutions had achieved a "Satisfactory" rating.

January 1, 2000, passed with no major Y2K problems occurring at FCA or within the FCS.

Regulatory, Policy, and Philosophy Initiatives

The FCA Board has legal authority to establish policy and prescribe regulations necessary to ensure institutions comply with the law and operate in a safe and sound manner. We strive to adopt sound and constructive policies and regulations, using a proactive and preventive approach that reflects the changing needs of agriculture. Our objective is to promulgate regulations that achieve safety and soundness goals while minimizing regulatory burden on System institutions.

During FY 1999, we took the first major step to implement the FCA Board philosophy statement on competition. We proposed a regulation that would provide FCS customers the freedom to do business with the FCS lender of their choice. No action has been taken on this rule yet and the Board continues to explore alternative approaches with the goal of selecting a course of action, which is both quick and fair. As required by the Farm Credit Act of 1971, as amended, we also proposed regulations specifying the procedures for an FCS institution's exit from the System. We adopted a final rule revising our investment regulations to provide FCS institutions increased investment flexibility, a wider range of investments, and improved investment practices. The FCA Board issued three policy statements. One reemphasized the importance of lending to young, beginning, and small farmers and ranchers; another provided guidance to FCS institutions on interest rate risk management practices; and a third encouraged System institutions to work closely with pork producers whose operations are under stress.

We also took action during the year to further reduce the regulatory burden on the System. The FCA Board approved a direct final rule that reduces the regulatory burden on the System by repealing or amending several regulations. These revisions provide System banks and associations with greater flexibility concerning loan sales, agricultural secondary market activities, letters of credit, information programs, travel expenses, and disclosing borrower information during litigation. We believe that such regulatory initiatives enable us to effectively ensure compliance with the law and the safety and soundness of the System while minimizing the burden on the institutions we regulate.

CONDITION OF THE FARM CREDIT SYSTEM

Mr. Chairman, I am pleased to report that the Farm Credit System remains in sound financial condition and continues to perform well despite the current adverse agricultural economic conditions. During 1999, the System earned more than $1 billion for the third consecutive year. The System's capital continued to grow totaling 15.2 percent of total assets at yearend 1999. This compares to total capital of 14.8 percent of total assets at yearend 1998. The System's credit quality improved during the past year even though general agricultural conditions deteriorated. Nonperforming loans decreased to 1.5 percent of total loans and other property at the end of 1999 compared to 2.1 percent at the prior yearend. The decrease in nonperforming loans was due largely to the improved credit quality of several large cooperative loans. The System's overall loan volume increased by almost $1.8 billion during the year. The allowance for loan losses continues to keep pace with the increase in loan volume. The System is also building the allowance for loan losses in anticipation that stressful agricultural economic conditions may lead to credit quality concerns in certain sectors.

The strength of the System's financial condition is reflected in our ratings of FCS institutions. A 1-rated institution is basically sound in every respect while a 5-rated institution has an extremely high, immediate or near-term probability of failure. More than 97 percent of FCS institutions were rated either 1 or 2 in December 1999. Currently, there are no 4 or 5 rated institutions and only five institutions rated 3. There are also no institutions under enforcement action, another indication of the System's sound financial condition.

We believe that the System is well positioned to handle the current difficult economic times for agriculture. Nevertheless, we are closely monitoring the effects of these adversities on the System and will respond appropriately if credit or financial deterioration occurs.

FEDERAL AGRICULTURAL MORTGAGE CORPORATION

The FCA has oversight and examination responsibility for the Federal Agricultural Mortgage Corporation, also known as Farmer Mac. We monitor Farmer Mac's operations and financial condition and provide periodic and timely reports to Congress. During 1999, we completed the development of a proposed risk-based capital regulation for Farmer Mac. We also continued to review Farmer Mac's debt issuance and nonmortgage investment strategy, and we reviewed Farmer Mac's strategic and operational business planning. In 1999, Farmer Mac had $6.9 million in net earnings, compared to $5.7 million in 1998. Farmer Mac's capital level remains above the minimums prescribed by the Act and its total loan program activity continued to increase, reaching $2.08 billion at September 30, 1999.

FISCAL YEAR 2001 BUDGET REQUEST

Mr. Chairman, we are proud of our accomplishments as the safety and soundness regulator of the Farm Credit System and of our ability to contain costs while fulfilling our mission. I assure you, Mr. Chairman, during fiscal year 2001 we will continue with our commitment to effectiveness and cost-efficiency. We will regularly review how additional progress can be made in meeting our objectives as I am personally committed to a program of continuous improvement.

Mr. Chairman, before I present the budget request, I respectfully bring to the Committee's attention that FCA's administrative expenses are paid for by the institutions we examine. FCA does not receive a Federal appropriation, but instead is funded through annual assessments of System institutions.

For fiscal year 2001, I propose a budget of $36.8 million. While this is an increase of $1.0 million, or 2.8 percent, above the $35.8 million requested for fiscal year 2000 operations, I can assure you that we are cognizant of our responsibility to be good stewards of the System's resources. Most of this increase is due to adjustments in compensation and benefits for our workforce. We are required by the Financial Institution Reform, Recovery, and Enforcement Act of 1989 (FIRREA) to keep FCA salaries comparable with those of other Federal financial institution regulators.

Our fiscal year 2001 budget request supports a staffing level of 310 FTEs. This will allow us to maintain the right mix of positions and skills necessary to implement our strategic plan and accomplish our mission. The proposed budget submitted last month provides details on the various expense categories and other highlights.

In conclusion, we are proud of our efforts and accomplishments in ensuring the safety and soundness of the Farm Credit System. We will continue to efficiently manage our resources while performing this mission in the way Congress intended. Mr. Chairman, on behalf of my fellow Board member Ann Jorgensen and myself, I thank you for the opportunity to share this information with you.